HB 84

Department of Legislative Services

Maryland General Assembly
2004 Session

FISCAL AND POLICY NOTE

House Bill 84 (Delegate Ross)
Ways and Means

Sales and Use Tax - Taxation of Luxury Services

This bill expands the definition of a taxable service under the sales and use tax to include specified services.

The bill takes effect July 1, 2004.

Fiscal Summary

State Effect: Potential general fund revenue increase of approximately $100.8 million in FY 2005, increasing in the out-years based on projected sales tax growth and incorporating a projected 1% decline in taxable sales. To the extent that sales decline further than projected, sales tax revenues would decline correspondingly.

($ in millions)	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
GF Revenue	$100.8	$104.3	$107.9	$111.7	$115.6
Expenditure	$0	$0	$0	$0	$0
Net Effect	$100.8	$104.3	$107.9	$111.7	$115.6

Note:() = decrease; GF = general funds; FF = federal funds; SF = special funds; - = indeterminate effect

Local Effect: Decrease in local admissions and amusement (A&A) tax revenue to the extent that the State sales tax is applied to services currently subject to local A&A taxes.

Small Business Effect: Meaningful. To the extent that the additional sales tax rate encourages consumers to shift purchases to out-of-state or remote sellers and away from Maryland retailers that are small businesses, these small businesses could experience a meaningful negative impact. Small businesses involved in the services specified by the bill may also experience additional costs associated with collecting and remitting the sales tax.

Analysis

Bill Summary: The bill imposes the sales and use tax on a variety of services listed in **Exhibit 1**.

Current Law: The following services are subject to the sales and use tax: (1) fabrication, printing, or production of tangible personal property by special order; (2) commercial cleaning or laundering of textiles for a buyer who is engaged in a business that requires the recurring service of commercial cleaning or laundering of the textiles; (3) cleaning of a commercial or industrial building; (4) cellular telephone or other mobile telecommunications service; (5) "900," "976," "915," and other "900"-type telecommunications service; (6) custom calling service provided in connection with basic telephone service; (7) a telephone answering service; (8) pay per view television service; (9) credit reporting; (10) a security service, including: a detective, guard, or armored car service; and a security systems service; and (11) a transportation service for transmission, distribution, or delivery of electricity or natural gas, if the sale or use of the electricity or natural gas is subject to the sales and use tax.

Although they are not considered services under the sales and use tax, the tax also applies generally to such things as rentals of tangible personal property, restaurant meals, hotel rooms, and utilities (although specific exemptions are allowed for residential purchases of electricity and gas).

Background: Maryland's sales and use tax, originally enacted in 1947, is the State's second largest source of general fund revenues, accounting for $2.7 billion in fiscal 2003. Historically, the sales and use tax has been imposed broadly on the sale or use of tangible personal property, but only narrowly on a few specifically enumerated taxable services. Over the past few decades, the growth in sales and use tax revenues has not kept pace with the growth in personal income, as the tax base has eroded due to several factors. One major contributing factor cited for the erosion of the sales tax base is a major shift that has occurred in the national economy from consumption of goods, the traditional base of the tax, to consumption of services. Based on personal consumption expenditure data from the U.S. Department of Commerce, expenditures on services rose from 48% of total personal consumption expenditures in 1980 to 59% in 2002, while spending on goods fell as a percentage of total consumption. Average annual growth in expenditures was 7.7% for services versus 5.5% for goods over the same period.

About half of the states that impose sales taxes essentially do not tax any services other than utilities, rentals of property, restaurant meals, hotel rooms, and admissions and amusements. Only five states (including two that impose gross receipts taxes on businesses that are not technically sales taxes) have taxes that generally apply to all services. About 10 states impose the sales tax broadly on services related to tangible personal property, such as fabrication, installation, and repair services. Several states also tax at least a few other personal services, and a few states also tax some business services.

Among surrounding jurisdictions, New Jersey, Pennsylvania, West Virginia, and the District of Columbia tax a broad range of repair services, including automotive repairs. Pennsylvania and West Virginia also tax some business services, and West Virginia also taxes some personal services. Delaware, which does not have a sales tax, is considered to have a broad taxation of services under its gross receipts tax, which applies to most businesses.

State Revenues: Based on data from the *1997 Economic Census* conducted by the U.S. Census Bureau, the Bureau of Labor Statistics' *2001 Consumer Expenditure Survey*, and the Bureau of Economic Analysis' *Personal Consumption Expenditure Report*, it is estimated that general fund revenues could increase by approximately $101.8 million in fiscal 2005 absent any reduction in sales due to the imposition of the sales tax as proposed by the bill. Exhibit 1 outlines the potential revenue resulting from each of the services subject to the sales tax under the bill. The estimate is based only on those services where there was either consumption or expenditure data available upon which to base an estimate.

Exhibit 2 shows the revenue resulting from the bill assuming a 1% reduction in taxable sales, whereby additional collections would decline from $101.8 million to $100.8 million. Future year revenues are expected to increase by approximately 3.5% annually. The 1% decline in taxable sales reflects sales that no longer are subject to Maryland sales tax for two reasons: (1) the sale does not take place at all because the cost dissuades the purchaser; or (2) the sale is diverted to a neighboring state where the service is not subject to a sales tax or the sales tax rate is lower. To the extent that sales decline further than projected, sales tax revenues would decline correspondingly.

Exhibit 1
Potential Revenue Resulting from the Taxation of Specified Services by Service Category
($ in millions)

Service Category	**FY 2005**
Telephone paging[6]	$0
Motor vehicle audio installation/repair	n/a
Boat or aircraft maintenance/repair	--
Marina[1]	$7.0
Aircraft parking/hanger fees	n/a
Self-storage	--
Home moving[2]	$8.0
Horse boarding or training	$1.3
Kennel services	n/a
Pet walking	n/a
Tanning[4]	$11.4
Massage	n/a
Physical fitness training	n/a
Sauna or steambath membership or service[5]	$17.0
Body tattoo or piercing	n/a
Dating or escort service	n/a
Bodyguard service[6]	$0
Personal shopper service[7]	n/a
Home cleaning	$10.0
Upholstery and furniture cleaning	$1.5
Window cleaning	n/a
Floor cleaning	n/a
Swimming pool or hot tub cleaning/repair	n/a
Interior decorating and design	$2.0
Closet and storage design[7]	n/a
Lawn and grounds care and landscaping	$8.0
Jewelry repair and cleaning	$1.0
Custom jewelry repair and fabrication[6]	$0
Fur and clothing storage	n/a
Gift wrapping[7]	n/a
Art conservation and restoration	n/a
Art or antique brokerage	n/a
Commissions on auction purchase/sales	$0.3
Golf course membership and fees	$11.0
Arcades and video games	$3.0
Bowling alleys	$2.0
Miniature golf	$0.3
Theater performances[3]	$10.0
Sightseeing tours	$6.0
Total	**$101.8**

n/a: Estimate unavailable.
[1]Includes marinas and boat repair.
[2]Includes self-storage.
[3]Includes movies.
[4]May include other products sold by tanning salons.
[5]Generally these are included in the price of a health club membership or stay at a resort or spa. The estimate assumes that the sauna/steam bath charge is not stated separately, making the entire membership or spa fee taxable.
[6]Already subject to taxation.
[7]Revenue assumed to be minimal.
Sources: *U.S. Economic Survey*, 1997; *Personal Consumption Expenditures*, 2001, Bureau of Economic Analysis; *Consumer Expenditure Survey*, 2001, Bureau of Labor Statistics

Exhibit 2
Potential Revenue Resulting from the Taxation of Specified Services
($ in millions)

	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
Taxation of Services Estimate	$101.8	$105.3	$109.0	$112.8	$116.8
Implied Sales Tax Base	2,035.5	2,106.7	2,180.4	2,256.8	2,335.7
Sales Base after 1% Decline	2,015.1	2,085.6	2,158.6	2,234.2	2,312.4
GF Revenue after 1% Decline in Sales	**$100.8**	**$104.3**	**$107.9**	**$111.7**	**$115.6**

State Expenditures: The Comptroller states that any expenses incurred with implementing this bill can be absorbed within existing budgeted resources. To the extent that existing resources are inadequate in future years, the Comptroller will seek additional resources through the annual budget process. Legislative Services questions the agency's ability to collect taxes from (and audit) these vendors with existing resources.

Local Revenues: For items subject to a local A&A tax, the combined tax rate (A&A plus sales) cannot exceed 10%. Therefore, any local government that imposes an A&A tax over 5% on an item that would be subject to the sales tax under this bill would be required to lower its A&A tax and hence lose A&A tax revenue.

Also, some jurisdictions including Calvert County and Chesapeake Beach, North Beach, and Hampstead (in Carroll County) exempt items that would otherwise be subject to the A&A tax if the item is subject to the sales tax, and they would lose revenue on items subjected to the sales tax.

Exhibit 3 lists jurisdictions that impose an A&A tax rate over 5%, so they could lose revenue from one or more of the services specified in the bill:

Exhibit 3
Jurisdictions That Could Lose Revenue As a Result of Taxing Specified Services

County	Taxing Jurisdiction
Allegany	County, plus Cumberland, Frostburg
Anne Arundel	County, plus Annapolis
Baltimore City	City
Baltimore	County
Carroll	County, plus Manchester, Mount Airy, Westminster
Cecil	County, plus all towns except Elkton
Charles	County
Frederick	Brunswick, Frederick, New Market
Garrett	Friendsville, Grantsville, Mountain Lake Park, Oakland
Harford	Aberdeen, Bel Air
Howard	County
Kent	Rock Hall
Montgomery	County, plus Barnesville, Brookeville, Chevy Chase View, Chevy Chase Village, Drummond, Friendship Heights, Gaithersburg, Garrett Park, Glen Echo, Martin's Additions, North Chevy Chase, Oakmont, Rockville, Takoma Park, and Washington Grove
Prince George's	County, plus Berwyn Heights, Bladensburg, Bowie, Brentwood, Cheverly, Cottage City, District Heights, Fairmount Heights, Glenarden, Greenbelt, Hyattsville, Landover Hills, Laurel, Mt. Rainer, New Carrollton, Seat Pleasant, and Upper Marlboro
St. Mary's	Leonardtown
Washington	Clear Spring, Hancock, and Williamsport

Small Business Effect: As discussed above, increasing the number of services subject to the sales tax in Maryland may result in a decline in consumer purchases of these services from State providers. To the extent possible, residents may purchase more services in neighboring states where these services are not taxed (or are taxed at a lower tax rate) or may choose not to purchase these services at all. The extent to which this may happen cannot be reliably estimated, but the majority of Maryland residents live within a short distance to a neighboring state and therefore could have access to service providers located in other states. While the percentage will vary from service to service, it is likely that many of the service providers in each of the service categories in Exhibit 1 are small businesses.

Additional Comments: The Comptroller advises that the bill could create significant compliance problems. Many of the services listed in the bill are often performed by independent contractors or on a casual basis. A significant amount of resources would have to be devoted to ensure compliance (which could exceed the value of the revenue received for some items), or a significant amount of the tax may not be collected. This would place established businesses, where enforcement is easier, at a competitive disadvantage. The following services could pose this type of problem: home moving services; home cleaning; home window cleaning; swimming pool/hot tub maintenance and repair; lawn, grounds and landscaping; pet walking; massage; physical fitness training.

In addition, there are also several definition problems that would likely require the Comptroller to adopt regulations that could lead to litigation. Among those noted by the Comptroller are art, personal aircraft, and theater performances.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Comptroller's Office, Department of Legislative Services

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